CHAPTER 2: OVERVIEW OF SECTION 502

2.1 INTRODUCTION

This chapter provides an overview of key aspects of the Section 502 program. Section 1 identifies the various types of loans available and details the circumstances in which each kind of loan can be made. Section 2 describes the Agency's Dedicated Loan Origination and Servicing (DLOS) System. The chapter concludes with Section 3, a broad-brush overview of the steps involved in processing Section 502 loans.

SECTION 1: TYPES OF LOANS

2.2 OVERVIEW

The rules governing Section 502 loan origination differ slightly, depending upon the type of loan being made. The types of loans available under Section 502 include:

- Initial loans;
- Assumed loans;
- Subsequent loans; and
- Nonprogram loans.

This section describes the four types of loans and how they differ. The interest rate for SFH loans can be found in Exhibit B of RD Instruction 440.1.

2.3 INITIAL LOANS

Initial loans are made when neither the applicant nor the seller has an existing Agency loan. Generally, they are made for the maximum loan term for which the applicant qualifies, and at the Rural Housing (RH) 502 low or moderate interest rate. If no prior Agency loans are involved in the transaction and the loan is to be made on program terms, this is the type of loan used.

2.4 ASSUMED LOANS

Section 502 loans may be assumed. The terms and conditions of the assumption depend upon the eligibility of the new purchaser.

A. New Rates and Terms Assumption

Most assumptions of Section 502 loans are ***new rates and terms assumptions*** -- that is, the purchaser assumes responsibility for all or a portion of the remaining debt, including principal and recapture receivable amounts. In order to conserve the Agency's budgetary resources, the transaction does not involve paying off the old loan and issuing a new initial loan. Instead, the purchaser assumes the outstanding debt, which is reamortized at new rates and terms. If the new purchaser and the property are eligible for the Section 502 program, the loan can be assumed on program terms. In addition, eligible new purchasers may receive subsequent loans to make up the difference between the amount of debt assumed and the purchase price, or may be able to obtain a leveraged loan. If the property does not meet Agency standards or will not be brought to Agency standards with the use of loan funds, or the new purchaser is not eligible, the loan can be assumed on nonprogram terms. Purchasers who assume the loan under nonprogram terms are not eligible for a loan to cover amounts above the amount assumed.

B. Same Rates and Terms Assumption

In certain limited cases -- generally those involving transfers of title between family members -- a ***same rates and terms assumption***, is permitted. Under this type of assumption, the existing note terms, including the interest rate and the remaining repayment period, do not change.

The new owner need not be income-eligible for a Section 502 loan. However, payment subsidy can be continued for new owners only if they are eligible for subsidy, and only at the level for which the new household qualifies.

Same rates and terms assumptions are permitted for the following types of transfers:

- A transfer from the borrower to a spouse or children not resulting from the death of the borrower;
- A transfer to a relative, joint tenant, or tenant by the entirety resulting from the death of the borrower;
- A transfer to a spouse or ex-spouse resulting from a divorce decree, legal separation agreement, or property settlement agreement;

- A transfer to a person, other than a deceased borrower's spouse, who wishes to assume the loan for the benefit of persons who were dependent on the borrower at the time of death, if the dwelling will be occupied by one or more persons who were dependent on the borrower at the time of death, and there is a reasonable prospect of repayment; or

- A transfer into an *inter vivos* trust in which the borrower does not transfer rights of occupancy in the property.

2.5 SUBSEQUENT LOANS

Subsequent loans can be issued as part of the original purchase of a property in combination with an assumption, or during the term of an Agency loan to help an existing borrower pay for repairs or improvements to the property. The key differences between processing requirements for subsequent and initial Section 502 loans are described in Exhibit 2-1 and are discussed in detail in later chapters.

Exhibit 2-1

Key Processing Differences for Subsequent Loans

- A new appraisal is not required for subsequent loans in cases where the loan is for $5,000 or less or an appraisal has recently been completed and accurately reflects the value of the property, as described in Paragraph 5.16 A.

- When an area designation has been changed from rural to nonrural, as described in Paragraph 5.3 C.4., subsequent loans may be made only to make necessary repairs, to pay equity in connection with an assumption of a program loan, or to permit the remaining borrower, if eligible, to purchase the equity of a departing coborrower.

- The Agency may reamortize an initial loan at the time a subsequent loan is made in cases where the borrower cannot reasonably be expected to meet installment payments unless the account is reamortized, as described in Paragraph 7.20 B.2.

- For subsequent loans to existing borrowers for minimal essential repairs to protect the Government's security, the best mortgage obtainable will be accepted in lieu of full title clearance, as described in Paragraph 5.12 B., and appraisal fees will be waived.
- Applicants have a legal right to cancel a subsequent loan within 3 business days from whichever of the following activities occurs last: (1) execution of the mortgage or deed of trust; (2) receipt of *Form RD 1940-41, Truth in Lending Statement*; or (3) receipt of *Form RD 1940-43, Notice of Right to Cancel*. Loan funds cannot be disbursed until the 3 business days have passed, unless a hardship exists and the applicant waives their right to cancel the loan in writing, as described in Paragraph 8.6 C.2. *Form RD 1940-43* is not used for subsequent loans made in conjunction with an assumption since the applicant does not have title to the property.

2.6 NONPROGRAM LOANS

Nonprogram loans are loans made on nonprogram terms to borrowers who are not program-eligible, and/or for properties that do not meet Agency standards and will not be brought to Agency standards with the use of loan funds. The interest rate offered is somewhat higher than for program-eligible borrowers, but is competitive in the marketplace. Borrowers with nonprogram loans are not eligible for program benefits, such as payment subsidy, or for servicing actions, such as moratoriums. They also are exempt from occupancy restrictions and the requirement to refinance with private credit. Nonprogram loans are discussed in detail in Chapter 11. The circumstances in which the Field Office can originate nonprogram loans are discussed below.

A. Facilitate Sale By an Existing Agency Borrower

When an existing Agency borrower wishes to sell a security property, the Agency will assist the borrower by allowing any creditworthy purchaser to assume all or a portion of the outstanding debt on new rates and terms. If the purchaser does not qualify for assistance under the Section 502 program, the loan may be assumed on nonprogram terms. Nonprogram purchasers acquiring a property from an Agency borrower are only permitted to assume existing debt; new credit cannot be extended to them through a subsequent loan.

B. Facilitate Sale of Real Estate Owned (REO) Property

The Agency may offer credit for the purchase of REO property on nonprogram terms to borrowers who are not program-eligible, and/or for properties that are not program-eligible.

SECTION 2: THE DEDICATED LOAN ORIGINATION AND SERVICING SYSTEM (DLOS)

2.7 DLOS

DLOS is designed to expedite loan-making, standardize information collection and record keeping, and facilitate communication between Field Offices and CSC. DLOS tracks loans from application through servicing using two interconnected systems: UniFi and FASTeller.

2.8 UNIFI

UniFi is a personal computer-based application used for loan origination. It retains applicant information, makes complex computations, and maintain a central record of all activities associated with an individual application from the time of pre-qualification through loan closing. UniFi's many data screens are linked so that once a piece of information is entered, UniFi will automatically transfer it to all pertinent data screens.

A few of UniFi's most important features include:

- Its ability to create a waiting list to help the Loan Originator select applications for processing in the proper order;
- Screens that automatically calculate maximum loan amount and payment subsidy; and
- The ability to print out many loan approval and closing forms with borrower information inserted.

Each Field Office must establish a schedule for purging UniFi records. Data must be maintained on UniFi until at least 1 full fiscal year after the last activity in the applicant's record.

2.9 FASTELLER

FASTeller is a mainframe-based application that is used to service Agency loans and monitor loan performance. It is linked to UniFi so that information from UniFi can be uploaded into FASTeller each night.

Field Staff can access certain areas of FASTeller to gather information on a borrower's account, such as determining the amortized loan amount on construction loans. The Loan Originator uses FASTeller to obligate funds and order checks.

FASTeller is also a communications device to help CSC and Field Staff keep abreast of each others' activities. If CSC needs on-site assistance for a servicing action, FASTeller can be used to communicate with Field Staff. For example, a Servicer involved in working out an insurance claim with a borrower might use the FASTeller work queue to ask Field Staff to visit the property to assess the repair work that has been done to date. Similarly, if a Loan Originator obtains information about a change in a borrower's employment status that has not been reported, FASTeller can be used to pass on that information to CSC.

SECTION 3: OVERVIEW OF LOAN ORIGINATION PROCESS

2.10 APPLICATION PROCESSING (Chapter 3)

When potential applicants express interest in the Section 502 program, the Loan Originator conducts preliminary screening to determine whether the household appears to qualify for a loan and what the loan amount is likely to be. Although the potential applicant may submit an application regardless of the outcome of the pre-qualification, this step can save the applicant and Agency staff time by letting potential applicants know in advance about any reasons that might cause them not to be eligible for a loan.

Processing Steps

This section outlines the steps involved in processing a Section 502 loan. It is intended to provide a conceptual overview of the process. The detail needed to fully understand each step follows in later chapters of this handbook.

When an applicant fills out an application and submits it to a Field Office, the Loan Originator must determine whether the application is complete, and ask follow up questions needed to understand the applicant's situation in enough detail to assess the household's priority status. The Loan Originator then makes a preliminary eligibility determination and notifies the applicant. In situations where processing cannot begin immediately, but the applicant appears to be eligible, the Loan Originator must place the applicant on a waiting list and inform the applicant when processing can be expected. As funds become available, applicants on the waiting list must be selected for processing in the appropriate order, based on priority status and application date.

2.11 BORROWER ELIGIBILITY (Chapter 4)

Once the application has been selected for processing, the Loan Originator must make a formal determination of the applicant's eligibility. This involves verifying the household's income, checking the credit history of all parties to the note, and reviewing all other eligibility requirements. Once the applicant's eligibility has been verified, the Loan Originator uses verified income information to determine the amount of payment subsidy the household is entitled to, and the maximum loan amount the applicant will be able to receive.

Based on this information, the Loan Originator counsels the applicant about the level of mortgage debt the household can afford, and issues a Certificate of Eligibility. The household then attempts to locate a home. In cases where the applicant has already submitted a contract for a property, no Certificate of Eligibility is needed.

2.12 PROPERTY REQUIREMENTS (Chapter 5)

Once the household has located a home or decided on the design of a dwelling to be constructed, they must provide key information to allow the Loan Originator to determine whether the property is modest and meets the Agency's underwriting guidelines. This includes the information needed to conduct an appraisal, to conduct an environmental review, and to verify that the site and dwelling meet, or will be constructed to meet, all applicable requirements.

2.13 TAXES, INSURANCE, AND ESCROW (Chapter 6)

Before underwriting the loan, the Loan Originator must have a good estimate of the impact that escrow payments for taxes, flood insurance, and hazard insurance will have on the household. The Loan Originator must estimate these costs for the purposes of underwriting, and work with the closing agent later in the process to get accurate figures to use in establishing escrow payments.

2.14 UNDERWRITING THE LOAN (Chapter 7)

If the applicant and the property meet the Agency's standards, the Loan Originator must determine the loan amount needed and whether it can be supported by the household's repayment ability. Repayment ability also is affected by the payment subsidy the household is entitled to, which is based on the household's adjusted income.

2.15 LOAN APPROVAL AND CLOSING (Chapter 8)

If the deal appears to meet the Agency's underwriting criteria, the Loan Approval Official reviews the case file and determines whether the loan can be approved. If the loan is approved, the Loan Originator notifies the applicant and obligates the funds.

The applicant then selects a closing agent. The closing agent is responsible for conducting the preliminary title clearance and for ensuring that the property conforms to the Agency's security requirements. The Loan Originator and closing agent work together to ensure that all required closing documents are prepared for signature at closing and that Agency funds arrive before the date of closing. The Loan Originator activates the loan in FASTeller after loan closing and prepares a loan docket to send to CSC for servicing.

When a new home is to be built or rehabilitation on an existing dwelling is involved, the Loan Originator also oversees the progress of construction. This involves ensuring that inspections are performed at appropriate points in the process, that mitigation measures established as part of any environmental review are properly implemented, and that funds are disbursed appropriately to pay for the work.